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The Massachusetts Tax Alert[®]

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**“New” 5.3 Percent Massachusetts Long-Term Capital Gains Rate
Retroactively Effective to January 1, 2002
125,000 Individuals, Estates and Trusts Affected**

DOR to Issue Proposed TIR Shortly

By Attorney Morris N. Robinson, CPA, LLM

Prior to May 1, 2002, the long-term capital gains of individuals, estates and trusts were subjected to six different tax rates depending on holding period. The highest rate was 5 percent for assets held for more than one year but less than two years. The lowest rate was zero percent for assets held for more than 6 years. There were four intermediate rates of 4 percent for assets held more than 2 years, 3 percent for assets held more than 3 years, 2 percent for assets held more than 4 years, and 1 percent for assets held more than 5 years. A zero tax rate resulted in no Massachusetts capital gains tax. Several years ago, the Massachusetts legislature eliminated these six different rates and substituted a single 5.3 percent tax rate for all long-term capital gains. The legislature attempted to make this rate-change effective for capital gains transactions completed on or after May 1, 2002.

On April 26, 2005 the Massachusetts Supreme Judicial Court retroactively rolled back this rate-change to January 1, 2002. (Peterson v. Commissioner of Revenue, 444 Mass. 128, 825 N.E.2nd 1029). On June 1, 2005 the Massachusetts Commissioner of Revenue, Alan LeBovidge informally commented on the Peterson case at the annual Massachusetts Tax Update Seminar sponsored by the Boston Bar Association. A description of his remarks follows. The Commissioner’s remarks were made with the understanding that they are not binding upon the Massachusetts Department of Revenue.

Over 125,000 individuals, trusts, estates, and Massachusetts Business Trusts are potentially affected by the retroactive rate-change. These taxpayers owe \$190 million representing \$165 million in additional capital gains taxes plus another \$25 million in interest. Over 76,000 taxpayers owe less than \$50, before interest and penalties. Another 10,000 taxpayers owe between \$50 and \$100, before interest and penalties. One taxpayer owes over \$14 million.

Commissioner LeBovidge intends to exercise his statutory authority and waive the additional taxes due from taxpayers who owe less than \$50, before interest and penalties. He will, however, seek to collect additional taxes totaling more than \$164 million from the remaining 49,000 taxpayers who owe more than \$50.

Under present law, the Department of Revenue must also collect about \$25 million in interest on the additional capital gains taxes. Mr. LeBovidge, however, announced that he will seek legislation forgiving the interest. In addition, he announced his intention to waive penalties if taxpayers pay their additional tax liabilities in the normal course. To prevent possible hardship, Mr. LeBovidge may also ask for legislation authorizing the Department of Revenue to enter into interest-free installment payment agreements. Under these agreements, taxpayers will be permitted to pay their additional tax in installments and without interest. The purpose of this possible legislation is to prevent hardship where a taxpayer invested the proceeds of a capital gains transaction – or simply spent it – and now cannot easily find the money to pay the tax.

Commissioner LeBovidge suggested that some taxpayers might have over-reported their capital gains. He noted that taxpayers had no incentive to be accurate if the tax rate was zero percent. In such cases, the taxpayer owed no taxes regardless of the amount of the capital gain reported. Commissioner LeBovidge therefore suggested that the Department of Revenue might begin the collection process by issuing Notices of Intention to Assess (“NIAs”) to all affected taxpayers. The NIAs will give these taxpayers 30 days to correct a potentially erroneous tax liability *before* the Department of Revenue actually issues tax bills. This procedure represents a special courtesy. The proposed adjustments are classified under the law as “clerical errors”; and the Department of Revenue normally adjusts “clerical errors” by sending out tax bills.

Commissioner LeBovidge’s remarks did not address some troubling issues regarding personal and transferee tax liability. Who is liable for the tax if a Massachusetts Business Trust reported a large capital gain subject to the old zero percent tax rate, paid no tax, promptly liquidated, and distributed the proceeds of sale to both in-state and out-of-state beneficiaries? Similarly, who is liable for the tax if the executor of an estate reported a large capital gain subject to the old zero percent tax rate, paid no tax, and made a final distribution to both in-state and out-of-state beneficiaries? Is the trustee of the Massachusetts Business Trust or the executor of the estate personally liable for the retroactive and unpaid capital gains taxes? Are the beneficiaries who received distributions personally liable as transferees? If so, is their tax liability joint and severable, meaning that a single beneficiary might be liable for the entire tax up to the value of the distribution he or she received? If one beneficiary pays the entire tax, does that person have a meaningful right of contribution against the other beneficiaries?

A Technical Information Release is expected shortly. The TIR is expected to confirm the Commissioner’s remarks. Hopefully, the TIR will also address the troubling issues of personal and transferee tax liability, outlined above.

Who We Are

M. Robinson & Company, P.C. represents businesses, business owners and not-for-profit organizations. We are experts in solving federal and state tax problems and in resolving tax disputes with the Internal Revenue Service and the Massachusetts Department of Revenue. We represent clients before the U.S. Tax Court, the Massachusetts Appellate Tax Board and the tax departments of foreign states such as New York, California and Pennsylvania. We also perform business succession planning and general estate planning for closely held businesses, their owners and professionals. *~End of Tax Alert*